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Weathering More Storms (literally) – September 2005

Earlier this year we looked back at the 2004 investment year and likened the investment climate at that time to "weathering storms" (visit "Newsletters" on www.WealthHealthLLC.com). Today, nearly three-quarters through the 2005 calendar year, the nation has been recently focused on weathering storms—literally. The impact that the recent Hurricanes Katrina and Rita will have on the national psyche, and the national wallet, is far too early to forecast. However, as is often the result of natural or manmade disasters, one would expect a sharp decline. The question for us, as your trusted advisor, is to assess whether such a decline will be short-lived, and purely reactionary, as many of the sudden impacts on the market tend to be when viewed in hindsight…mere blips on a long term basis.

We believe that our clients, whose asset allocations are based on sound financial plans, are well positioned to weather such storms. Our research has shown that a combination of domestic and international stocks, having both growth and value characteristics, has been less volatile than any stand alone asset class. And with growth and value performing similarly over time, adding diversification globally should tilt the risk/reward scale more towards reward. Violent events often rattle consumer confidence as this week's report indicates, causing sharp drops in the market which prove over the long term to be a blip. We have witnessed these blips many times before, including last decade's Hurricane Andrew, the bombing of the World Trade Center and Oklahoma City, as well as the September 11 attacks. All had sudden impacts on share prices but proved short lived, with no lasting damage to the economy over the long term. The graph below shows the Dow Jones Industrial Average from just after the attacks of September 11, 2001 through today. Despite a bumpy road, throughout this period the index has gone from approximately 8,000 to 10,500 for a return of over 30% (just under 8% annualized).

Which brings up the next issue…the long term. One would think that it is crucial to know whether interest rates are moving higher or lower, whether inflation is heating up or cooling off, whether the dollar is strengthening or weakening, and whether oil will hit $70/barrel. Although these day to day issues are seemingly important to investors, they are not useful to long term disciplined investors.

From www.bigcharts.com

This is so because companies are constantly making adjustments to the ever changing business environments so they can continue to grow. If they do not, shareholder value will reflect such inaction,

resulting in less capital investments, and possibly bankruptcy, takeover or merger. Over the last 35 years, earnings of S&P 500 companies have roughly doubled every 10 years, regardless of market and economic conditions. Yet, during this time frame, as well as throughout stock market history, any number of crises, such as wars, recessions, and speculative manias have surfaced.

We are experiencing a time of uncommonly low volatility (for purposes of this writing, the difference between the S&P 500 Index's high and low in a given time period.). Through June 30th of this year, the ISI volatility index is 8%, the average since 1945 being 26%. In only 5 previous years has it been less. Low volatility may lead to a stock market rally thus yielding "good volatility" – stocks leaping upwards. Research has shown that when volatility is low as it is now, a stock market rally tends to subsequently materialize. Another affirmation of the state of the market's low volatility is the Chicago Board of Options Exchange's S&P 500 Volatility Index, a 30-day volatility forecast for the S&P 500 index. It has fallen to about 12, its lowest level since 1995. It has proven to be one of the most reliable gauges of volatility. We think a lot of this reduction in volatility is the result of the colossal emergence of long/short investment strategies of hedge funds and the access to investment information made possible by the Internet. This has improved efficiency in the market, thus dampening volatility. This is not to say that the market is completely efficient, especially not in the short term and especially not in certain asset classes where the availability of information is not as easily accessible (i.e., mid and small cap as well as emerging market asset styles). This is where our active management can add real value to your portfolios.

For the year, we have been under a gray cloud of a wait and see attitude among investors' interest in such variables as interest rates, oil and gas prices and, more recently, the hurricanes of the Gulf Coast. With the stock market unlikely to exceed long term averages in the near term, we believe strongly that having built your asset allocations around your financial needs, including, but not limited to, your risk tolerance, income needs, and income tax situation as uncovered through our financial planning discipline, will prove to be particularly rewarding. Investing in equities for the short-term is a loser's game. Our responsibilities are not to act impulsively with knee-jerk reactions to the daily, monthly, or quarterly returns of the market or the money managers that we employ. Our experience has shown us that such manager reallocation creates high transaction costs, adverse tax consequences and goes against historical wisdom of a disciplined, long term investment approach.

Should you wish to discuss this communication in more detail or to review your portfolio, please do not hesitate to call us.

As always, we thank you for your continued trust and confidence in our abilities to serve your wealth management needs.

Sincerely,

Richard Coppa, JD, L.LM, CFP   Darin Gartland, CFP, EA

Please contact us at 1-973-535-9577 or e-mail any questions to us at info@WealthHealthLLC.com.